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CENTRAL INTELLIGENCE AGENCY
Office of Legislative Counsel
Washington, D. C. 20505
Telephone: [redacted]

19 March 1982

TO: Mr. Leon Fuerth
Permanent Select Committee on Intelligence
House of Representatives
Washington, D.C. 20515

Dear Leon:

The enclosed responds to your request for information pertaining Polish and East European debt.

[redacted]
Legislative Liaison

Enclosures

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Poland: Conflict Over Economic Reform

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Issues related to economic reform [1] are the focal point of the current political struggle between Solidarity and the regime. Solidarity delegates at the first session of their congress in Gdansk rejected the government's approach to worker self-management at the enterprise level and called for an unprecedented national referendum to decide the issue and for Solidarity members to boycott the Sejm's decision if it passed the government's bill. For its part, the government angrily reacted to Solidarity's actions, accusing the union of surrendering to extremist elements. Thus, the economic reform issue is now a major stumblingblock to Poland's attempt to recover from its economic crisis and to work out a *modus vivendi* between the two major forces on the Polish political scene—Solidarity and the party.

Economic reform proposals currently under discussion include elements of both the Hungarian reform, which focused on economic flexibility, largely through the use of market mechanisms, and the Yugoslav reform, which granted extensive political and economic power to workers to enable them to run their own plants. The Polish Government favors a reform more in the Hungarian mold, while the Solidarity leadership is insisting that workers be given a stronger role in self-government. The conflict is serious because it deals with the institutionalization of power.

Moreover, conflict over economic reform is likely to heat up in the months ahead as the government seeks to hammer out a wide range of specific laws in its effort to implement reform by early 1982. Solidarity will no doubt find other issues on which its position diverges significantly from that of the government, and serious confrontations are likely.

[1] We define economic reform as fundamental changes in the structure of the economic system, in institutions, and in economic mechanisms.

It is not possible at this time to assess the economic impact of the reforms under consideration since we do not know their final shape. While the introduction of self-management may satisfy some of Solidarity's demands, Yugoslavia's experience with inflation and chronic balance-of-payment problems point out that such a system will not be a panacea for Poland's economic problems. At the same time, debate over reform will hinder the formulation and implementation of plans and policies needed to cope with Poland's serious debt problems and the continuing deterioration in economic conditions. As the economic crisis deepens with the onset of winter, this might encourage Solidarity and the regime to compromise on some of the contentious issues. Even if the government and Solidarity agree to a reform program, there are other impediments to its effective implementation. The entrenched bureaucracy will resist changes that diminish their control over key economic decisions. There will also be problems related to the lack of trained and experienced management, particularly since management will have to respond to unfamiliar market-type stimuli. Finally, the introduction of economic reform could exacerbate Poland's economic problems and have a disruptive effect, at least initially.

Background

Economic reform is not a new issue in Poland. In 1970 and again in 1976, the Polish Government attempted to introduce a limited degree of decentralization and a larger role for market forces into the economy. Polish economists now admit that the reforms were half-hearted and were undermined by entrenched bureaucratic resistance. Moreover, in

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Other Communist

Poland Releases the 1982 Economic Plan

The recently released Polish economic plan for 1982 offers little prospect for a quick halt to Poland's economic slide and no relief for the long-suffering consumer. The plan sets out three possible scenarios for the economy—each keyed to certain levels of coal production. Under the best of circumstances, the most realistic option projects coal output at 168 million tons, a small increase from 1981 levels. Under this scenario, national income would decline 3.5 percent and industrial production would stagnate. All scenarios foresee a continuing decline in industrial production, at least through first-quarter 1982. They also predict that the consumer will have more money to spend in 1982 but will have fewer goods to buy in state markets, especially since meat supplies will continue to fall far short of demand. 25X1

Even the most realistic variant will be difficult to meet because it assumes that CEMA will allow Warsaw to run trade deficits, especially for raw materials. Such an assumption may not be warranted, however, given the tenor of early negotiations between Warsaw and its allies over 1982 trade plans. Moreover, there is no indication the government has consulted Solidarity on the plan. The regime will need union cooperation, especially in lessening the disruptions that will be caused by the planned introduction of economic reforms in Janua 25X1

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Romania: Economy Falters

Romania's domestic economic difficulties are both aggravating and feeding on its already weakening international financial position.[1] The regime's development policy, which has highly favored the industrial sector, is now beginning to take its toll. Economic growth is slowing sharply, primarily due to energy shortfalls and agricultural problems. Ceausescu has yet to alter his economic strategy and instead appears willing to place greater burdens on consumers.

Falling output of food and limited availability of consumer goods, however, are already stirring internal social and political tensions. Romania's precarious financial position, meanwhile, leaves little room for increased imports of consumer goods. Indeed, to alleviate the problem, Romania, already facing growing arrearages, will likely have to cut imports further. Even if the country obtains a rescheduling of its debt or additional help from the IMF, poor domestic performance will limit export gains, effectively ruling out sharp increases in imports

Past Economic Policy

Over the past two decades, Romania has emphasized rapid development of heavy industry. Roughly half of all investment funds have been allotted to industry, with emphasis on steel, chemicals, machine building, and petroleum refining. Economic growth has been high as a result, but the development stategy has imposed severe strains on the economy:

- Stress on industrial development has continued in the face of growing domestic energy production problems, which have forced Bucharest to rely increasingly on costly oil imports to maintain high levels of output. 25X1
- Agricultural production has stagnated the past five years—in part due to bad weather but mostly because of neglect.
- Serious economic reforms have been ignored, and the economy continues to be directed from the center by a bloated bureaucracy, with lower level managers and workers offered inadequate incentives. 25X1

Current Economic Developments

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In 1980 national income grew at the lowest rate since the late 1950s with agricultural production dropping 5 percent. The data available point to another poor performance in 1981. Industrial production was up only 4.5 percent as of midyear, about half the growth rate for the same period a year earlier. Ceausescu has lamented that production is below plan in such key sectors as extractive industries, transportation, and machine building. A late summer drought dimmed prospects for improvements in agriculture. The projected grain harvest of 18.5 million tons will be nearly a m... 25X1 tons below average, with most of the shortfall due to a poor corn crop. Some distress slaughtering of livestock may occur as winter approaches 25X1

[1] For a complete discussion of Romania's current financial difficulties, see "Romania: Hard Currency Situation Deteriorates," in the 18 September 1981 *IEEW*.

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International
Economic & Energy
Weekly [redacted] 25X1

20 November 1981

Perspective

Emerging Soviet Hard Currency Bind [redacted] 25X1

Moscow's hard currency position has turned sour. After building up a substantial foreign exchange cushion in the past two years, the USSR has been hit in 1981 by a soaring agricultural import bill, soft oil prices in the West, and stepped-up aid to Poland. As a result, the trade deficit is being driven nearly $6 billion into the red, more than double the deficit of last year. Nor can Moscow look for any relief in the years ahead. The Yamal gas pipeline—the only significant new potential foreign exchange earner in the 1980s—will not become operational until 1986 or later and even then is expected to be of only modest help.

The size and suddenness of the deficit has already begun to affect Soviet trade:
- Some imports of grain and other foods are being deferred and the volume of nonagricultural imports is falling.
- Selected purchases of chemical and other industrial materials are being cut.
- Except for business related to the Yamal pipeline, Soviet orders for new plant and machinery have been sparse.

As for financing its deficit, the USSR has already been seeking short-term bank credits for grain and other commodities normally bought on a cash basis. Moscow has also been dipping into cash reserves at a substantial pace. Soviet assets in Western banks fell from $8.6 billion to $3.6 billion in January-June, while liabilities to these banks increased from $7.7 billion to $8.5 billion.

The hard currency pinch is serious enough to influence Soviet economic relations with Eastern Europe. Moscow has again told its East European partners that they can no longer count on massive Soviet economic assistance. Moscow has already decided to reduce—by 10 percent or more—its highly subsidized exports of crude to some East European countries. The Soviets would stand to gain some $2 billion a year in hard currency earnings if all of the oil were diverted to the West. While providing relief for the USSR's hard currency trade accounts, the cutback will force the East Europeans to sharply increase their hard currency oil purchases and scale back production, which, in turn, provides a substantial portion of Soviet consumer goods.

How much longer the Soviets can count on Western bank confidence is less certain. The international banking community has become increasingly worried about Bloc creditworthiness as a result of the Polish financial disaster, and more recently, problems in Romania. But concern is also rising over slow economic growth, widening balance-of-payments deficits, inefficient management systems, and the generally poor export prospects in the other East European countries as well.

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Poland: The Financial Squeeze

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Poland is running out of time in its effort to stave off default. Although it has rescheduled $4.7 billion in 1981 debt service and received $5 billion in new credits and other hard currency assistance, Warsaw appears to have little hope of meeting a $500 million interest payment due on 10 December as a condition for rescheduling debt to private banks. The bankers and the Poles are scrambling for a solution to skirt the issue, but even if Poland manages to scrape through the rest of this year, it faces a huge borrowing requirement in 1982. With Poland's economic partners in the East and West increasingly unwilling to provide loans and assistance, default or a formal debt moratorium seems inevitable.

The financial crisis, meanwhile, continues to aggravate domestic economic problems. Warsaw has been unable to import raw materials and spare parts needed for production. Conversely, the weakened economy is unable to support an export drive that could help finance debt service payments and restore creditworthiness.

Financial Needs in Late 1981

Poland's financial needs are being driven by its huge debt service burden. For the final four months of 1981, Warsaw says it needs $1.7 billion in credits in addition to already arranged debt relief to pay the interest due to private banks, principal due to unspecified creditors, and short-term maturities which Warsaw expects that banks will refuse to roll over. With trade roughly in balance, Warsaw would use these credits to free export revenues for debt-service payments. Poland's request includes $1.2 billion in commodity credits, most of which probably have been committed by Western governments. The problem remains of making downpayments to gain access to these credit lines

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Terms of 1981 Bank Rescheduling

Amount of principal rescheduled	*95 percent* [a]
Rescheduling period	*7 years*
Grace period	*3 years*
Rescheduling fee	*1 percent*
Interest Rate on Rescheduled credits	*1.75 percentage points over LIBOR*

[a] *Remaining 5 percent is due in three installments in 1982.*

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Poland reached an understanding with Western banks in September on financial terms for rescheduling $2.4 billion in principal payments on unguaranteed debt due from 26 March, when Poland declared an informal moratorium on principal payments. The final agreement is not due to be signed until 10 December, by which time Warsaw must pay interest arrearages and meet its current interest obligations. The Poles now appear to have little chance of coming up with this money, although they claim to have cut imports recently to accumulate the necessary funds.

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USSR, Eastern Europe, and China:
Outlook for Growth and Current Account Balances

USSR

At the end of the first year of the Eleventh Five-Year Plan period (1981-85), the Soviet economy was beset with serious problems. Soviet GNP grew approximately 2 percent last year, the third consecutive year with growth at 2 percent or less. Soviet industry experienced its worst performance in the postwar period; industrial output in 1981 grew about 2 percent. At the same time, overall farm output was some 10 percent below that attained in 1978, the last peak year for agricultural output. Most significantly, the Soviets experienced their third consecutive poor grain harvest in 1981. Because record amounts of agricultural commodities had to be imported, Moscow's hard currency position deteriorated. Persistent food shortages, together with increased prices for luxury goods, left many Soviet consumers with less on their tables in 1981 and less in their pockets. 25X1

The response of the Soviet leadership to growing economic difficulties has been cautious and conservative. The Supreme Soviet ratified a revision of the 11th Five-Year Plan last November that made few changes in the original goals approved a year ago. Despite current problems in agriculture and industry,

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TABLE 2